TIME WARNER

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Carol A. Melton
Vice President-Law
and Public Policy

June 10, 1996

Mr. William Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 96-98

Dear Mr. Caton:

On June 10, 1996, Tom Morrow and Don Shepheard of Time Warner Communications met with Gina Keeney, Larry Atlas, Edward Krachmer, Melissa Newman, Tim Peterson and Richard Metzger of the Common Carrier Bureau. The discussion reflected comments filed by Time Warner in the above-referenced proceeding and included reference to the attached documents.

Sincerely yours,

Carol Melton

Carol A. Melton

enc.

cc: Gina Keeney
Edward Krachmer
Melissa Newman
Tim Peterson
Larry Atlas
Richard Metzger

TELECOMMUNICATIONS ACT OF 1996
IMPLEMENTATION OF LOCAL COMPETITION

The Section 252 Pricing Standards differentiate among the facilities/services required by the various classes of competitor (See Chart)

- Interconnection & Network Elements - Section 252 (d)(1)
  - Based on Cost: Economic Standard (TSLRIC)
  - Reasonable Profit: Policy Standard
    - Policy considerations should not economically deter facilities-based investment

- Transport and Termination - Section 252 (d)(2)
  - Based on Additional Costs: Economic Standard (LRIC)
  - Call Termination represents a permanent "last bottleneck"
  - While the NPRM suggests that the pricing standard for transport & termination could be the same as for interconnection & network elements, the statutory language and economics of the competitive business suggest that there is a legitimate differentiation.

- Resale - Section 252 (d)(3)
  - Retail rates less avoidable costs
  - Avoidable cost standard must consider net avoided costs. Wholesale prices must reflect costs of wholesale functions (billing, collections, customer services, etc.)
  - Artificially-contrived discounts that fund artificially-low rates change the economics of building competitive facilities
    - IXCs have attempted to exclude legitimate wholesale costs to justify steep discounts
    - IXCs' strategy has more to do with long distance competition than local competition. Looking for steep discounts to fund a "pre-emptive strike" against RBOCs in form of local service price war. (See *Wall St. Journal*, 5/30/96)
  - Relationship of the "cost of interconnection" to the "cost of resale" could potentially deter facilities-based investment decisions.

The Commission has authority to adopt Mutual Traffic Exchange under the 1996 Act

- Commission has broad authority under Section 251 (d)(1) to establish regulations implementing Section 251 obligations, including reciprocal compensation obligations in Section 251 (b)(5), and consistent with pricing standards set forth in Section 252 (d)(2).
- Mutual Traffic Exchange satisfies requirement for "mutual and reciprocal recovery" of costs by each carrier
- Mutual Traffic Exchange is <u>not</u> a system of *free* interconnection. It provides each carrier with a tangible economic benefit whereby carriers receive an "in-kind" payment rather than a cash payment.

Adopting a Mutual-Traffic-Exchange approach will help achieve Congress' goal of rapidly establishing competition in the local exchange marketplace

- Eliminates one of most contentious and time-consuming issues in negotiation. Texas requirement for nine-month interim period of Mutual Traffic Exchange may make the difference in TW Comm meeting its planned service rollout.
- Economically efficient where traffic is relatively in balance and long-run incremental costs are *de minimus.*
  - There is reason to expect that competitors will not attract a normal sample of the population segment, resulting in relatively balanced traffic. Compensation rates provide economic incentive to skew traffic balance.
  - Avoids Transaction costs which impose a relatively greater burden on new facilities-based entrants. (Such costs are not imposed on resellers.)
  - Transaction costs could exceed benefits of compensation rate
- An alternative to pure Mutual Traffic Exchange would be to apply compensation rates only to traffic outside a specified "zone of balance."

Regulations implementing pricing standards of 1996 Act should reflect a baseline view or "preferred outcome" and not preclude negotiated arrangements.

TELECOMMUNICATION ACT OF 1996
SECTION 252 PRICING STANDARDS

STATUTE REFERENCE	FACILITIES	STATUTORY REQUIREMENT	PRICING STANDARD
SECTION 252(d)(1)	INTERCONNECTION and NETWORK ELEMENTS	1.) BASED ON COST and 2.) REASONABLE PROFIT	TSLRIC POLICY
SECTION 252(d)(2)	TRANSPORT & TERMINATION (Call Completion)	MUTUAL & RECIPROCAL RECOVERY OF COSTS BASED ON *ADDITIONAL COSTS* OF CALL TERMINATION	LRIC
SECTION 252(d)(3)	FULL SERVICES	RETAIL RATES LESS AVOIDABLE COSTS	WHOLESALE

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AT&T Discounts Signal a National Price War

By John J. Keller
Staff Reporter of The Wall Street Journal

The war over local telephone service has begun.

AT&T Corp., taking the offensive to foil local phone companies aiming to capture its long-distance business, is preparing pre-emptive discount pricing for local phone service in numerous U.S. markets.

The first of these pricing moves came yesterday in the Illinois market controlled by Ameritech Corp., a Baby Bell. AT&T said it would offer new customers three months of free, unlimited "local-toll" calling in the Illinois region. These toll calls go beyond a local market without crossing long-distance boundaries. AT&T also said that it would extend deep discounts on its local rates thereafter and that customers could apply their local-toll calls to their current AT&T discount plans, giving them even larger discounts on long-distance service.

AT&T already offers cheap toll calls in California and New York, but the plan unveiled yesterday is one of the first to offer free calling to lure newcomers — and it presages further offensive maneuvers. "In competitive markets you can only be aggressive, giving the customers value, or you will lose," says Joseph Nacchio, AT&T's president of consumer services. Noting the new competition for AT&T's long-distance customers, Mr. Nacchio vows that "we will be the market leader when the dust settles — and will be as aggressive as necessary to get there."

In Connecticut, AT&T is contemplating new price cuts as a way to thwart the surprising success that the local service provider, Southern New England Telecommunications Corp., has had in selling long-distance service to state residents. SNET already has grabbed 10% of the long-distance market in the state from AT&T and others — raising the alarming prospect for AT&T of losing a similar share in other states as the Baby Bells begin long-distance business. So AT&T is weighing whether to offer Connecticut customers a flat rate of five cents per minute on all calls — long-distance, local or toll service. That would amount to less than half the current discounted rates.

The latest moves indicate that the first big battleground in the new era of phone competition, brought about by the telecommunications deregulation law passed earlier this year, will be in local-toll calls. Ultimately, the richest terrain to capture will be long-distance, a $70 billion market, and regular local service, a $100 billion business.

Key AT&T Battlegrounds

	[illegible]	Competitors
[redacted]	Nation's largest service	MCI, Sprint, WorldCom, and numerous smaller [illegible]. In the future, the regional Bells, GTE and smaller local phone companies.
	Plan to enter all 50 states. Current hot spots: Illinois, Michigan, California, New York and Texas.	Ameritech, SBC-Pacific Telesis*, Bell Atlantic-Nynex*
	Nation's largest [illegible], covers 30% [illegible] to expand to 80% within two years.	Bells, GTE, Sprint and newer PCS services
	AT&T WorldNet service aimed at other Internet and on-line offerings.	America Online, Netcom, MCI and others.
	AT&T to begin selling direct-broadcast service nationwide this summer.	Entrenched cable-TV operators, MCI-News Corp. and other DBS operators
	Data and network facilities management	IBM, EDS, Andersen Consulting and MCI

*Pending mergers, each [illegible]
Source: AT&T and analyst reports

But neither will be easy pickings: The seven Baby Bells must meet a "checklist" of requirements to ensure they have opened their local monopoly to competition before being allowed into long-distance, which could take some of them two years or more; in local service, new rivals must rent local lines from the Bells and other monopolies or, in a costly and less likely strategy, build local networks of their own.

For AT&T, the toll-free offer in Ameritech country and the planned action in Connecticut most likely reflect a resolve to protect its long-distance base of 90 million customers by keeping its new rivals busy protecting their own turf. In long-distance, AT&T currently has an edge with consumers and roughly a 60% share.

In recent years, the prices of long-distance service from the big three providers — AT&T, MCI Communications Corp. and Sprint Corp. — have usually differed by about a penny or two a minute. That is bound to change once new long-distance entrants such as the Bells come in. AT&T appears to have anticipated that challenge — by cutting prices on the local front rather than coming up with yet another discount plan in long-distance.

Holding on to customers is crucial as the telecom rivalry heats up and AT&T and other carriers move toward offering a bundle of local, long-distance, wireless and video services. Such packages could help AT&T retain customers without

Please Turn to Page B15, Column 1

Continued From Page B1

expensive marketing, including such common enticements as $100 checks. AT&T and its rivals in long-distance currently spend more than $10 billion annually to sell service.

Ameritech has become AT&T's first major target because, among the Bells, it is one of the furthest along in meeting the checklist that would allow it to invade AT&T's turf. AT&T's offer of free service runs Aug. 1 to Oct. 31 and covers calls that travel more than 15 miles in Illinois but remain in the local toll calling area. The Chicago-based Bell seemed to welcome AT&T's offer — in part because the local competition could help Ameritech get into the long-distance market even sooner. "Free seems like pretty aggressive competition to me," says an Ameritech spokesman, noting that Ameritech offers toll-calling discounts but no free service.

In addition to the free offer, AT&T is revising its rates in Illinois. Under this new plan, a five-minute call between Chicago and suburban Glenview would cost up to 21% less than Ameritech's basic local-toll rates, AT&T says.

With their monopoly control of most local customers and phone lines, the Bells and GTE Corp. could inflict deep wounds in AT&T's long-distance franchise. AT&T, after spinning off its NCR computer business and Lucent equipment unit to shareholders, will be left with a core long-distance business that generates some $50 billion in annual revenue.

Meanwhile, AT&T watchers say the company has had a huge increase in customer turnover — the so-called churn rate. One person who has seen the numbers says AT&T's churn in the past five months "is up 25% to 40% over the company's last all-time high" in mid-1994.

Mr. Nacchio says, "Industry churn is up, therefore ours is up. . . . There are 500 companies in the U.S. selling long-distance services now."